200449

LeBoeuf, Lamb, Greene & MacRae
L.L.P.

A LIMITED LIABILITY PARTNERSHIP INCLUDING PROFESSIONAL CORPORATIONS

1875 CONNECTICUT AVENUE, N.W.
WASHINGTON, DC 20009-5728
(202) 986-8000
TELEX: 440274 FACSIMILE: (202) 986-8102

NEW YORK
WASHINGTON, D.C.
ALBANY
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WRITER'S DIRECT DIAL:
(202) 986-8050

November 17, 2000

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Mr. Vernon A. Williams
Secretary, Surface Transportation Board
1925 K Street, N.W., 7th Floor
Washington, D.C. 20423

Re: Ex Parte No. 582 (Sub-No. 1), Major Rail Consolidation Procedures

Dear Secretary Williams:

Enclosed are the original and 25 copies of the "Opening Comments of Edison Electric Institute" for filing in the above-referenced proceeding, and a diskette containing the Comments in WordPerfect format.

Also enclosed are three additional copies for date stamping and return via our messenger.

Very truly yours,

Michael F. McBride

Michael F. McBride

Attorney for Edison Electric Institute

Enclosures

cc: All Parties of Record

200419

UNITED STATES OF AMERICA
SURFACE TRANSPORTATION BOARD

EX PARTE NO. 582 (SUB-NO. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

OPENING COMMENTS OF EDISON ELECTRIC INSTITUTE

Michael F. McBride
Bruce W. Neely
LeBoeuf, Lamb, Greene & MacRae, L.L.P.
Suite 1200
1875 Connecticut Avenue, N.W.
Washington, D.C. 20009-5728
(202) 986-8000

Attorneys for Edison Electric Institute

Due Date: November 17, 2000
Dated: November 17, 2000

UNITED STATES OF AMERICA
SURFACE TRANSPORTATION BOARD

EX PARTE NO. 582 (SUB-NO. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

OPENING COMMENTS OF EDISON ELECTRIC INSTITUTE

INTRODUCTION AND SUMMARY

Edison Electric Institute ("EEI") is encouraged that the Board proposed changes in its railroad consolidation policy to enhance competition, assure adequate service, and require that benefits of proposed railroad consolidations be demonstrated with greater assurance. The proposed policy changes, if implemented through specific rules that assure that competition would be enhanced and that adequate service would be maintained, are appropriate policy, especially given the results of the last several railroad consolidations. However, EEI is concerned that the proposed rules themselves would <u>not</u> actually assure that the Board's stated policies would be carried out.

The proposed rules would appear to permit <u>any</u> conceivable Class I railroad merger, acquisition, or control transaction so long as the application satisfies the informational requirements the Board is also proposing. In each of the last several consolidation proceedings, after all, the applicant carriers have contended that the transaction in question would enhance competition, assure adequate service, and produce demonstrable public benefits. The Conrail acquisition by CSX and Norfolk Southern was only the latest example of such claims, but of course the claimed benefits of, say, taking one million trucks off the highways, have not materialized, and service is worse instead of better.

Given the public statements of Canadian Pacific Railway, CSX Transportation, Norfolk Southern Railway, and Union Pacific Railroad that they objected only to the timing of the proposed Burlington Northern-Santa Fe Railway/Canadian National Railway merger,[1] it must be assumed that the first merger transaction announced after the Board's new rules take effect will trigger other mergers. Based on recent history, as well as on public statements, we can expect that the relentless pace of major rail consolidations will continue, even if the exact timing is not clear. One might expect that the Class I railroads with service problems or low stock prices will want to wait, but if, for example, BNSF and CN were again to announce a merger, other such mergers would almost certainly occur, regardless of the state of service in the industry, and regardless of the financial condition of the other Class I railroads. After all, Union Pacific now claims its service problems are behind it, and so have NS and CSX more recently. The prerequisite for further consolidations that CP, CSX, NS, and UP set out in their "Open Letter to Railroad Customers" has thus been satisfied, and they presumably would instruct their counsel to draft an application which they would contend would satisfy the Board's proposed rules if the right transaction opportunity presented itself. EEI must therefore presume that the relentless pace of rail mergers will continue and that the STB must make the same presumption.

The new merger[2] rules must therefore have the "teeth" to enhance competition, assure adequate service, and require demonstrable public benefits. As of now, the proposed rules do not have the "teeth" needed to assure that these objectives will be met. EEI is particularly distressed that

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[1] See "Open Letter to Railroad Customers," January 11, 2000 in The Wall Street Journal, among other publications.

[2] For convenience, we use "merger" to mean merger, acquisition, or control, i.e., any form of railroad consolidation proceeding involving Class I railroads.

it proposed several such specific conditions in its Comments in response to the Board's ANPR, but for the most part they were not proposed by the Board. Even the one that was, open gateways, was not accompanied by a necessary condition, that the gateway be open economically as well as physically, to make the condition meaningful. This issue is particularly important because mergers of each of the two the western U.S. Class I railroads with each of the two eastern U.S. Class I railroads could otherwise make it essentially impossible for the Dakota, Minnesota & Eastern Railroad ("DM&E") to compete with UP and BNSF for transportation of western low-sulfur coal to the Midwest and the East.

Moreover, the Board did not propose to protect shippers from increases in rates and charges after a merger, it did not propose to prevent railroads from passing through acquisition premiums paid in such transactions, it did not propose to use the full extent of its authority to compel terminal trackage rights, it did not say it would protect "3 to 2" shippers from loss of competition, and it did not propose compensation to shippers for inferior service as a result of a merger, among other such proposals. EEI again urges the Board to propose specific rules that would become conditions of any approvals of Class I rail mergers that would assure shippers and smaller railroads that they would be protected as a result of such transactions. EEI contends that the Board is required to respond to important comments submitted to it in its final rules.

THE VIEWS OF EEI ON THE ANPR.

The comments of EEI on the ANPR were quite specific. Rather than repeat verbatim what EEI proposed, we hereby refer the Board to EEI's comments on the ANPR, and urge the Board to address them specifically. EEI is concerned that the Board has not responded to its specific suggestions, which may imply that the Board does not agree with them. However, this is not clear. EEI urges the Board to respond to the important comments made by each party, which the Administrative Procedure Act requires. *E.g., American Mining Congress v. EPA*, 907 F.2d 1179, 1188 (D.C. Cir. 1990), *citing ACLU v. FCC*, 823 F.2d 1554, 1581 (D.C. Cir. 1987), *quoting Home Box Office, Inc. v. FCC*, 567 F.2d 9, 35 n.58 (D.C. Cir. 1977), *cert. denied*, 485 U.S. 969 (1978).[3]

THE VIEWS OF EEI ON THE NPR.

In its proposed rules, the Board said that it would ensure that future rail mergers will enhancing competition, assure adequate service, and require that the demonstrated benefits of a proposed transaction be more certain. While EEI endorses those policy objectives, EEI is concerned that the Board's proposed rules do not assure that those outcomes will be achieved. In fact, in most if not all recent mergers, the Applicants have claimed that the transaction in question would achieve, and there is nothing in the proposed rules that would demonstrate that those claims would not be accepted.

The Board also indicated that it would no longer issue informal opinions approving voting trusts, but rather those would be approved only by the Board itself, rather than by its Secretary. EEI supports that change. Surely, if the Board had considered whether to allow CSX and NS to spend most of the money they spent to acquire Conrail <u>before</u> they spent it, rather than <u>after</u>, as the Board did in Finance Docket No. 33388, and knew then what it knows now, it might well have agreed with the comments of certain EEI members that it should <u>not</u> have allowed those expenditures. The current financial woes of CSX and NS can be directly traced to their acquisition of Conrail.

[3] The Board summarized parties' comments in an Appendix to the NPR. But that, while useful, is not what is needed to satisfy the APA; the APA requires that the Board <u>respond</u> to the important comments, as the cited authorities hold.

But the Board adopted almost none of the specific proposals made by EEI or other shipper interests on the ANPR, nor did it propose any specific, "bright-line" rules, except ones procedural in nature, that were proposed by other parties, including rail labor and short lines.

We are thus faced with a dilemma -- may we rely on the Board's generalized assurances that it will enhance competition, assure adequate service, and require a more definite and certain showing of benefits before it will approve a merger? Or are we to read into the proposed rules a rejection of the specific suggestions that were made by various parties?

Unfortunately, it is not likely that we can assume the best <u>from the rules themselves</u>, even if we can assume the best about the Board's intentions. That is because, even given the best intentions, the proposed rules would permit any conceivable remaining rail merger.

BNSF and CN, after all, contended that their proposed merger would enhance competition, assure adequate service, and provide a more certain and substantial showing of public benefits. So one would have to assume that those two rail carriers could make the showing the Board's proposed rules require, and be approved. If so, the Board's refrain about "balanced competition" would almost compel the approval of the remaining mergers necessary to keep the remaining carriers of approximately equal size to a merged BNSF-CN. It is therefore clear that the process would inevitably lead to two major railroads in North America. The only question is "when?"

The rules, therefore, actually provide the Board with <u>greater</u> discretion than before, and produce greater uncertainty as to when mergers will occur and what conditions the Board will impose on them.

But the greatest problem with the proposed rules is that the Board made clear that industry-wide measures to promote competition in the railroad industry[4] are not for the Board to consider, but rather are for Congress. NPR at 16-17. One thing is therefore clear: the Board is not going to lead the effort to adopt industry-wide solutions to the problem of lack of competition in the rail industry. Make no mistake, the Board could do so if it wished. It could, for example, repeal the infamous MidTec decision, which has prevented any shipper from obtaining relief under the terminal trackage rights provision of the statute, but the Board has not proposed to do that. Apparently, such remedies will have to come from Congress.

Beyond industry-wide solutions, the proposed rules will almost certainly lead to one of two unpalatable alternatives: either no mergers, and a continuation of the status quo, or one merger leading to another and another, to maintain what the Board has called "balanced competition," with the inevitable result that there will be only two Class I railroads in the United States, or even in all of North America. Shippers regard either alternative as undesirable.

For that reason, the shipping community will seek legislation in the next Congress. EEI does not further address those matters in these Opening Comments, as the Board has made it clear that it considers them outside the scope of this proceeding.

EEI offers the following comments on the proposed rules:

1. **Bottleneck Rates**. Contrary to some reports, as EEI reads the proposed rules the Board in the NPR proposed no change in its "bottleneck" rate decisions. All the Board appears to have said is that, if a shipper has a contract rate over the "non-bottleneck" carrier before a merger, it will

[4] The Board referred to proposals for industry-wide relief as "open access," even though most shippers have taken pains to say that they are not advocating that remedy.

require a separately published rate over the "bottleneck" segment after a merger. The only shipper which has achieved those circumstances, even without a merger, is FMC Corp. Its circumstances were somewhat unique, as it obtained contracts outside the West, then challenged "bottleneck" rates only in the Western territory. Also, its case developed during the "bottleneck rate" litigation. It is not likely that the situation in the FMC proceeding will recur.

As the Board knows, shippers are not satisfied with the "bottleneck rate" decisions of the STB, and will continue to urge Congress to amend the statute to grant the Board power to compel railroads to publish "bottleneck rates" so that either the competition that then can occur over the non-bottleneck segment will occur, as shippers believe Congress intended in the Staggers Rail Act of 1980, or as a last resort a shipper can challenge the "bottleneck rate" at the STB. Otherwise, mergers can create larger and larger monopolies without regulatory action to assure that competition that can occur will occur. But we understand that the STB considers itself not to have the authority to compel the publication of "bottleneck" rates, except where the contract exception applies, so EEI will not belabor the point here.

In the merger context, the Board acknowledged in the NPR that it has broad powers to adopt conditions in mergers to protect the public interest. It follows that the Board could adopt conditions requiring the merging railroads to offer "bottleneck rates" wherever they are the only carrier to serve a particular shipper. That would enhance competition over the "non-bottleneck" segments. The best ways to avoid such legislation would be for the Board to adopt a changed interpretation of the statute, or at least to adopt such a condition in any subsequent merger. Since each of the Nation's Class I railroads is likely to be involved in at least one more merger, such a condition would ultimately resolve the problem. (It is clear under the D.C. Circuit's merger moratorium decision that the Board could not indefinitely preclude parties from filing merger applications.)

2. **Terminal Trackage Rights**. The Board's decision in MidTec to require a shipper to show "competitive harm" before the terminal trackage rights provisions of the statute could be invoked was not compelled by the language of the statute. Indeed, the Board applies the same provision in merger proceedings without requiring a showing of "competitive harm," but typically where a competing railroad is involved, rather than for a shipper. Thus, for example, the Board may order trackage rights under this provision to make the merging railroad more efficient, but will not apply the same rationale where the shipper seeks relief. Certainly, the Board cannot argue that its MidTec decision cannot be overruled, but it continues to decline to do so, without saying why. But shippers have concluded that the Board will not do so of its own volition. Therefore, and because shippers believe Congress intended that the "terminal trackage rights" provision be applied generally and without being limited only to those situations in which the shipper could prove "competitive harm," shippers will seek relief from Congress.

3. **Elimination of "Paper" and "Steel" Barriers**. Many parties argued that shortline and regional railroads could play a significant role in certain circumstances in maintaining or enhancing competition, if only the Board were to outlaw "paper" barriers, at least prospectively. But the Board did not. The Board declined, as in other respects, to provide assurance that it would rely on such alternate carriers for relief in defined situations, even though the Board recognized that shortline and regional railroads could be a competitive option. The Board did not indicate that it would require the restoration of physical connections that railroads have obstructed with "steel" barriers.

When the Board fails to make clear its intention to provide alternate carriers with the ability to provide competition, it discourages them from participating in merger proceedings to seek such relief, because the cost of participation in such proceedings is substantial. The Board should make clear its intention to provide such a remedy a requirement in appropriate circumstances.

4. **Service Standards**. As it now stands, rail carriers either pay no penalty at all in many such circumstances of inadequate service, or, even worse, charge increased rates or charges to make up for any lost profit. While a few shippers have sued for loss of contractually agreed minimum levels of service, we are not aware of reported cases establishing obligations of railroads to pay damages for inadequate service for tariff shippers. The Board should establish a framework for measuring such damages, and a clear obligation on the part of the railroads to pay such damages, in the event that service declines after a merger.

EEI is particularly frustrated that the Board suggested that the merging railroads propose their own service standards and penalties for failing to meet them. A right without a remedy is no right at all, and at this time it would appear that shippers have no remedies for inadequate service unless their contracts provide for one. The Board will not have done all that it can do to assure adequate service <u>unless</u> it imposes financial penalties on railroads who fail to provide appropriate service as a result of a merger.

5. **Open Gateways**. Here, the Board did indicate with some specificity that it is likely not to allow open gateways to be closed. But even in such circumstances, the Board did not acknowledge that unless it acts to ensure that a gateway can be <u>economically</u> kept open, it is not truly "open." Even such parties as Union Pacific urged the Board to keep gateways <u>economically</u> as well as <u>physically</u> open. Most gateways which could be closed have been closed, so the Board's new

policy may be of little practical value. The Board should act to ensure that mergers will not cause gateways to be closed, economically or physically, with the only conceivable exception being that there are compelling circumstances requiring their closure.

EEI is particularly concerned about this issue because the fate of the DM&E may depend on it. DM&E intends to transport coal to railroads other than UP and BNSF, such as the Illinois Central, I & M Rail Link, and through them, to CSX and NS, in competition with UP and BNSF. If UP and BNSF each merge with one of the two eastern Class I railroads, DM&E will not be able to compete absent protection of its existing gateways. If it is likely, as many appear to believe it is, that there will only be two Class I railroads in the United States before too long, then it is essential that the Board adopt a policy that would ensure that railroads such as the DM&E, who can provide much-needed competition in certain regions, be protected from the effects of such transcontinental mergers.

6. **"3 to 2" Shippers**. Most economists insist that two competitors are not enough to assure competition. The evidence suggests that two potential competitor railroads may collude, or settle into a comfortable "dual monopoly" situation, while three competitors create far greater uncertainty that such understandings may hold, and thus result in a more competitive outcome. Where there are three competitors, the Board should ensure that three competitors will remain.

7. **"One-Lump" Theory**. In any future merger proceeding, shippers will likely argue that a rail merger that extends a railroad's geographical reach extends its monopoly power, requiring a remedy, and that reliance on the "one-lump" theory would be mistaken. The Board should make clear that it will take a more active role in determining whether the evidence supports the theory, including requiring the Applicants to provide evidence necessary to test whether the theory applies.

8. **Acquisition Premiums**. The Board has an affirmative duty to protect customers, especially captive customers, from increases in rates and charges, especially where acquisition premiums have been paid. Other agencies provide such protection. The Board should decide now to provide such relief, and ask the Second Circuit for a voluntary remand of this issue in the pending Conrail appeals. This issue is important not just to shipper interests. Merging railroads would be better served if the Board's rules clearly provided that they will not be allowed to pass such premiums on to their customers. Mergers would then likely include only smaller premiums that the merging railroads could absorb, or none at all (using stock swaps instead, as have some recent transactions).

9. **Single-Line Service**. FERC and other agencies attempt to ensure that merging companies do not cause harm to any customer due to a merger. The STB should do likewise. Where mergers cause shippers to go from single-line to two-carrier service, it should either adopt conditions to prevent that, or, at a minimum, require that the carriers guarantee, under pain of financial penalties, that service not deteriorate after a merger. Customers, especially captive customers, should not be required to bear the brunt of the service failures that are caused by mergers that they had no part in encouraging.

10. **ADR For Service Failures**. EEI is aware that the Board has a new "hot line" for service complaints. EEI proposes that the Board formalize the process somewhat, for shippers who so desire. EEI proposes that merging railroads agree, as a condition of approval of the transaction, that they will participate in shipper-initiated arbitration, mediation, or negotiation in which the shipper asserts that it has suffered from worse service as a result of the merger. The Board could, in this fashion, provide shippers with some assurance that their grievances might be expeditiously

addressed, by some professional who presumably has the time to do so promptly, in a confidential setting if that is what the shipper desires. EEI is willing to allow the railroads to suggest procedures that they believe would make this process fair. EEI anticipates that reply comments will allow the Board to get sufficient information from the parties to adopt final rules in this proceeding to assure shippers that such ADR processes will provide an effective and efficient process for resolving service disputes.

CONCLUSION

The proposed rail merger rules are an improvement in the sense that the Board has acknowledged that prior mergers have harmed competition, impaired service, and not produced the pubic benefits that were supposed to result from them. The proposed rules, nevertheless, are not adequate. They are not adequate because they are not specific, making it unclear whether the comments of parties such as EEI were accepted or rejected, leaving almost totally to the Board's discretion whether a proposed merger would satisfy the Board's policies. Moreover, under the Administrative Procedure Act, the Board has an obligation to respond to important comments which, thus far, it has not done.

Many, if not all, parties desire greater certainty about the new merger rules so that they may make an intelligent choice whether to participate in a merger proceeding and so as to reduce the costs of participation if they do intervene. In any event, without industry-wide policy changes to promote rail-to-rail competition, the Board's proposed rules almost certainly will produce one of two undesirable outcomes: either a continuation of the status quo with rail competition and degraded service, or only two major railroads in all of North America -- which, if possible, may be even worse than the status quo.

The Board simply has chosen not to grapple with broader issues of industry-wide concern, whether in this proceeding or in other proceedings, leaving shippers no choice but to pursue legislative remedies for these problems. Shippers are emphatically of the view that the industry-wide issues of lack of competition or adequate regulatory remedies are more important than whether to allow the Class I railroads to consolidate. Yet the Board has made revision of its consolidation rules its highest priority, instead of industry-wide relief.

Because future rail mergers remain not only permissible, but likely, EEI believes the Nation is headed to a future of two Class I railroads in North America. Such a future makes the need for rail-to-rail competition more and more urgent. The Board could promote that goal in this proceeding, and EEI urges it to do so to the maximum extent that it believes its statutory authority permits. EEI has identified a variety of specific proposed rule changes that would assist in accomplishing that objective, and once again urges the Board to adopt its proposals.

Respectfully submitted,

Michael F. McBride

Michael F. McBride
Bruce W. Neely
LeBoeuf, Lamb, Greene & MacRae, L.L.P.
Suite 1200
1875 Connecticut Avenue, N.W.
Washington, D.C. 20009-5728
(202) 986-8000

Attorneys for Edison Electric Institute

Due Date: November 17, 2000
Dated: November 17, 2000

CERTIFICATE OF SERVICE

I hereby certify that on this 17th day of November, 2000, I have served copies of the foregoing "Opening Comments of Edison Electric Institute" on the following persons by first-class mail:

Richard Allen, Esq.
Zuckert Scoutt & Rasenberger LLP
888 17th Street, NW, Ste. 600
Washington, DC 20006-3309

Mr. Anthony Anikeeff
Alliance of Automobile Manufacturers
1401 H Street, NW, Ste. 900
Washington, DC 20005

Mr. David Bain, Jr.
Massachusetts Executive of Transportation
101 Park Plaza, Ste. 3170
Boston, MA 02116

Mr. Rex Beasley
Kansas Office of the Attorney General
120 SW 10th Street Memorial Hall
Topeka, KS 66612

Mr. Michael Benoit
Procter & Gamble Company
1 Procter & Gamble Plaza
Cincinnati, OH 45202-3315

L. Blaine Boswell
PPG Industries Inc.
One PPG Place
Pittsburgh, PA 15272

Mr. Michael Briley
Shumaker Loop & Kendrick
North Courthouse Square
1000 Jackson
Toledo, OH 43624-1573

John H. Broadley, Esq.
John H. Broadley & Associates, P.C.
1054 - 31st Street, NW, 2nd Floor
Washington, DC 20007

Sandra Brown, Esq.
Troutman Sanders LLP
1300 I Street, NW, Ste. 500 East
Washington, DC 20005-3314

Ms. Glenda Cafer
Kansas Corporation Commission
1500 SW Arrowhead Road
Topeka, KS 66604

Rachel Danish Campbell, Esq.
Hopkins & Sutter
888 16th Street, NW
Washington, DC 20006-4103

Mr. Thomas Canter
Western Coal Transportation Association
4 Meadow Lark Lane, Ste. 100
Littleton, CO 80127-5718

Mr. Kenneth Chaney, Jr.
Southern Company Services, Inc.
600 N. 18th Street
Birmingham, AL 35219

Mr. Edward Cristenbury
Tennessee Valley Authority
400 West Summit Hill Drive
Knoxville, TN 37902

Mr. Gordon Chu
Vancouver Port Authority
200 Granville Street
Vancouver BC V6C 2P9
CANADA

Mr. David Church
Canadian Pulp and Paper Association
1155 Metcalfe Street
Montreal PQ H3B 4T6
CANADA

Charles Clay, Esq.
Head Seifert & Vander Weide PA
120 South 6th Street
One Financial Plaza, Suite 2400
Minneapolis, MN 55402

Mr. E. Thomas Coleman
Vice President, Government Relations
BASF Corporation
601 13th Street, N.W.
Washington, DC 20005

Paul Coleman, Esq.
Hoppel Mayer & Coleman
1000 Connecticut Avenue, NW, Ste. 400
Washington, DC 20036

Mr. Robert Culliford
Guilford Rail System
Law Dept, Iron Horse Park
North Billerica, MA 01862

Paul Cunningham, Esq.
Harkins Cunningham
801 Pennsylvania Avenue, NW, Ste. 600
Washington, DC 20004-2664

John Cutler, Jr., Esq.
McCarthy Sweeney Harkaway PC
1275 K Street, NW, Suite 600
Washington, DC 20037

Ms. Sandra Dearden
MDCO Transportation Management Ltd.
166 West Washington, Ste. 700
Chicago, IL 60602

Jo A. DeRoche, Esq.
Weiner, Brodsky, Sidman & Kider, P.C.
1300 19th Street, N.W., Firth Floor
Washington, DC 20036-1609

Nicholas DiMichael, Esq.
Thompson Hine & Flory LLP
1920 N Street, NW, Ste. 800
Washington, DC 20036-1601

Mr. Pete Dinger
American Plastics Council
1300 Wilson Blvd, Ste. 800
Arlington, VA 22209

Paul Donovan, Esq.
LaRoe Winn Moerman & Donovan
3800 Highwood Court, NW
Washington, Dc 20007

Kelvin Dowd, Esq.
Slover & Loftus
1224 17th Street, NW
Washington, DC 20036

Ms. Diane Duff
Alliance For Rail Competition
1920 N Street, NW, Ste. 800
Washington, DC 20036

Richard Edelman, Esq.
O'Donnell Schwartz & Anderson PC
1900 L Street, NW, Ste. 707
Washington, DC 20036

Mr. Robert Elder
Maine Department of Transportation
16 State House Station
Augusta, ME 04333-0016

Mr. Daniel Elliott, III
United Transportation Union
14600 Detroit Avenue
Cleveland, OH 44107-4250

Mr. Stephen Ferree
Westvaco Corporate Center
1011 Boulder Springs Drive
Richmond, VA 23225

Mr. John Ficker
Weyerhaeuser Company
PO Box 2999
Tacoma, WA 98477-2999

Mr. David Finklea
Greater Houston Partnership
1200 Smith, Ste. 700
Houston, TX 77002-4400

Mr. Janet Gilbert
Wisconsin Central System
6250 North River Road, Ste. 9000
Rosemont, IL 60018

Louis Gitomer, Esq.
Ball Janik LLP
1455 F Street, NW, Ste. 225
Washington, DC 20005

Mr. David Goffin
Canadian Chemical Producers Association
350 Sparks Street, Ste. 805
Ottawa, ON K1R 7S8
CANADA

Andrew Goldstein, Esq.
McCarthy, Sweeney & Harkaway
2175 K Street, NW, Ste. 600
Washington, DC 20037

Edward Greenberg, Esq.
Galland, Kharasch, Greenberg, Fellman
& Swirsky, PC
1054 31st Street, NW, Ste. 200
Washington, DC 20007-4492

Mr. Donald Griffin
Brotherhood of Maintenance of Way
Employees
10 G Street, NE, Ste. 460
Washington, DC 20002

Mr. Wayne Hammon
Director of Government Relations
National Association of Wheat Growers
415 Second Street, N.E., Suite 300
Washington, DC 20002

Ms. Natalie Harder
Buffalo Niagara Partnership
300 Main Place Tower
Buffalo, NY 14202-3797

Ms. Maureen Healey
Society of the Plastics Industry Inc.
1801 K Street, NW, Ste. 600K
Washington, DC 20006-1301

John Heffner, Esq.
Rea Cross & Auchincloss
1707 L Street, NW, Ste. 570
Washington, DC 20036

J. Michael Hemmer, Esq.
Covington & Burling
PO Box 7566
1201 Pennsylvania Avenue, NW
Washington, DC 20004

Mr. William Hickman
Exxon Mobil Global Services Company
13501 Katy Freeway
Houston, TX 77079-1398

Member of Congress
Honorable Rick Hill
US House of Representatives
Washington, DC 20515

Eric Hocky, Esq.
Gollatz Griffin & Ewing
PO Box 796
213 West Miner Street
West Chester, PA 19381-0796

Mr. Dennis Howard
Oklahoma Department of Agriculture
2800 N. Lincoln Blvd.
Oklahoma City, OK 73105

Ms. Claudia Howells
Oregon Department of Transportation
555 13th Street, NE, Ste. 3
Salem, OR 97301-4179

Ms. Karen Huizenga
MidAmerican Energy Company
106 East Second Street
Davenport, IA 52801

Mr. Forrest Hume
1281 West Georgia Street, Ste. 201
Vancouver, BC V6E 3J7
CANADA

Terence Hynes, Esq.
Sidley & Austin
1722 Eye Street, NW
Washington, DC 20006-5304

Mr. Thomas Jackson
Iowa Department of Transportation
800 Lincoln Way
Ames, IA 50010

Mr. George Jelly
Shell Chemical Company
PO Box 2463
One Shell Plaza
Houston, TX 77252-2463

Mr. James Johnson
Empire Wholesale Lumber Co.
PO Box 249
Akron, OH 44309-0249

Mr. Wayne Johnson
McKinley Paper Company
10501 Montgomery Blvd, Ste. 300
Albuquerque, NM 87111-3846

Erika Jones, Esq.
Mayer Brown & Platt
1909 K Street, NW
Washington, DC 20006-1101

Mr. Richard Jones
Bentonite Performance Minerals
410 17th Street, Ste. 800
Denver, CO 80202

Fritz R. Kahn, P.C.
1920 N Street, N.W., Eighth Floor
Washington, DC 20036-1601

Mr. Jonathan Kazense
Keokuk Junction Railway Co.
1318 South Johanson Road
Peoria, IL 61607

Timothy Kenealy, Esq.
Eckert Seamans Cherin & Mellott, LLC
1250 24th Street, NW, 7th Floor
Washington, DC 20037

Mr. Charles King, President
Snavely King Majors O'Connor & Lee, Inc.
1220 L Street, N.W., Suite 410
Washington, DC 20005

Mr. J. Peter Kleifgen
Statesrail Railroad
7557 Rambler Road, Ste. 280
Dallas, TX 75231

Mr. Robert Korpanty
US Dept. of Army, Military Traffic Management Command
720 Thimble Shoals Blvd, Ste. 130
Newport News, VA 23606-2574

Mr. Kenneth Koss
California Public Utilities Commission
505 Van Ness Avenue
San Francisco, CA 94102-3298

Member Of Congress
Honorable John Lafalce
US House of Representatives
Washington, DC 20515-3229

Ms. Sharon Lauritsen
US Department of Agriculture
PO Box 96456
Washington, DC 20090-6456

Mr. Joseph Lema
National Mining Association
1130 17th Street, NW
Washington, DC 20036-4604

Mr. Larry Lemond
Eastern Shore Railroad Inc.
PO Box 312
Cape Charles, VA 23310

John LeSeur, Esq.
Slover & Loftus
1224 17th Street, NW
Washington, DC 20036-3081

Mr. Timothy Lovain
Denny Miller McBee Associates Inc.
400 N. Capitol Street, NW, Ste. 363
Washington, DC 20001

Dennis Lyons, Esq.
Arnold & Porter
555 12th Street, NW, Ste. 940
Washington, DC 20004-1206

Gordon MacDougall, Esq.
1025 Connecticut Avenue, NW, Ste. 410
Washington, DC 20036

John Maser, III, Esq.
Thompson Hine & Flory LLP
1920 N Street, NW, Ste. 800
Washington, DC 20036-1601

Mr. Nicholas Matich
General Motors
PO Box 9015
30400 Mound Road
Warren, MI 48090-9015

Mr. Ian May
Council of Forest Industries
1200 - 555 Burrard Street
Vancouver, BC V7X 1S7
CANADA

George Mayo, Jr., Esq.
Hogan & Hartson LLP
555 13th Street, NW, Columbia Square
Washington, DC 20004-1109

Thomas McFarland, Jr., Esq.
McFarland & Herman
20 North Wacker Drive, Ste. 1330
Chicago, IL 60606-2902

Mr. Robert McGeorge
US Dept. of Justice, Antitrust Div.
325 7th Street, NW, 5th Floor
Washington, DC 20530

Mr. Robert Merhige III
Virginia Port of Authority
600 World Trade Center
Norfolk, VA 23510

Mr. Jon H. Mielke
Executive Secretary
North Dakota Public Service Commission
600 E. Boulevard Avenue, Department 409
Bismark, ND 58505-0480

Christopher Mills, Esq.
Slover & Loftus
1224 17th Street, NW
Washington, DC 20036

Mr. John Mittleider
North Dakota Barley Council
505 40th Street, SW, Ste. E
Fargo, ND 58103-1184

G. Paul Moates, Esq.
Sidley & Austin
1772 Eye Street, NW
Washington, DC 20006

Ralph Moore, Jr., Esq.
Shea & Gardner
1800 Massachusetts Avenue, NW
Washington, DC 20036-1872

Karl Morell, Esq.
Ball Janik LLP
1455 F Street, NW, Ste. 225
Washington, DC 20005

Jeffrey Moreno, Esq.
Thompson Hine & Flory, LLP
1920 N Street, NW
Washington, DC 20036-1601

William Mullins, Esq.
Troutman Sanders LLP
1300 I Street, NW, Ste. 500 East
Washington, DC 20005-3314

Mr. Gary Myers
The Fertilizer Institute
501 Second Street, NE
Washington, DC 20002

Member of Congress
Honorable Jerrold Nadler
US House of Representatives
Washington, DC 20515

Mr. Kurt Nagle
American Association of Port Authorities
1010 Duke Street
Alexandria, VA 22314

Mr. Robert Neff
Ameren Services
One Ameren Plaza
PO Box 66149, MC 611
1901 Chouteau Avenue
St. Louis, MO 63166-6149

Mr. Richard Newpher
American Farm Bureau Federation
600 Maryland Avenue, SW, Ste. 800
Washington, DC 20024

Keith O'Brien, Esq.
Rea Cross and Auchincloss
1707 L Street, NW, Ste. 570
Washington, DC 20036

Mr. Edward Wytkind
Transportation Trades Dept, AFL-CIO
1025 Connecticut Avenue, NW, Ste 1005
Washington, DC 20036

Mr. James Peterson, Marketing Director
North Dakota Wheat Commission
4023 State Street
Bismarck, ND 58501-0690

Mr. Hunter Prillaman
National Lime Association
200 North Glebe Road, Suite 800
Arlington, VA 22203-3728

Honorable Jack Quinn
U.S. House of Representatives
Washington, DC 20515-3230

Mr. Richard Tre
Seneca Sawmill Company
P.O. Box 851
Eugene, OR 97440-0851

Mr. James P. Redeker
New Jersey Transit
One Penn Plaza - East
Newark, NJ 07105-2246

David C. Reeves, Esq.
Troutman Sanders, L.L.P.
1300 I Street, N.W., Suite 500 East
Washington, DC 20005-3314

Edward J. Rodriquez, Esq.
General Counsel
Housatonic Railroad Company, Inc.
P.O. Box 687
Old Lyme, CT 06371

Mr. John Jay Rosacker
Kansas Department of Transportation
217 S.E. 4th Street, 2nd Floor
Topeka, KS 66603

Robert D. Rosenberg, Esq.
Slover & Loftus
1224 17th Street, N.W.
Washington, DC 20036

Mr. Harold A. Ross
Brotherhood of Locomotive Engineers
1370 Ontario Street
1548 Standard Building
Cleveland, OH 44113-1740

Alice C. Saylor, Esq.
Vice President & General Counsel
American Short Line and Regional Railroad Association
1120 G Street, N.W., Suite 520
Washington, DC 20005-3889

Mr. Richard J. Schiefelbein
Woodharbor Associates
7801 Woodharbor Drive
Ft. Worth, TX 76179-3047

Mr. John Schmitter
DTE Transportation Services
350 Indiana Street, Suite 600
Golden, CO 80401

Mr. Thomas A. Schmitz, President
TAS Consulting, Inc.
P.O. Box 71066
Chevy Chase, MD 20813-1066

Mr. James E. Senner
Simpson Timber Company
P.O. Box 460
Shelton, WA 98584

Mr. Philip G. Sido
National Starch & Chemical Company
10 Finderne Avenue
Bridgewater, NJ 08807

Samuel E. Sipe, Jr., Esq.
Steptoe & Johnson, L.L.P.
1330 Connecticut Avenue, N.W.
Washington, DC 20036-1795

Mr. Richard G. Slattery
Amtrak
60 Massachusetts Avenue, N.E.
Washington, DC 20002

William L. Slover, Esq.
Slover & Loftus
1224 17th Street, N.W.
Washington, DC 20036

Paul Samuel Smith, Esq.
U.S. Department of Transportation
400 Seventh Street, S.W.
Room 4102 C-3
Washington, DC 20590

Mr. Robert Smith
Twin Modal Incorporated
2621 Fairview Avenue N.
Roseville, MN 55113-2616

Charles A. Spiltunik, Esq.
Hopkins & Sutter
888 16th Street, N.W.
Washington, DC 20006-4103

Scott N. Stone, Esq.
Patton Boggs, L.L.P.
2550 M Street, N.W., 7th Floor
Washington, DC 20037-1346

Mr. Steven D. Strege
North Dakota Grain Dealers Association
118 Broadway, Suite 606
Fargo, ND 58102

Robert Szabo, Esq.
Van Ness Feldman
1050 Thomas Jefferson Street, N.W.
6th Floor
Washington, DC 20007

Vincent P. Szeligo, Esq.
Wick Streiff Meyer O'Boyle & Szeligo, P.C.
1450 Two Chatham Center
Pittsburgh, PA 15219-3427

Eric W. Tibbetts
Manager, Rail Center
Chevron Chemical Company LLC
1301 McKinney Street
Houston, TX 77010-3029

Merrill L. Travis
Illinois Department of Transportation
2300 S. Dirksen Parkway, Room 302
Springfield, IL 62754

Mr. Christopher Tully
Transportation Communications
International Union
3 Research Place
Rockville, MD 20850

Mr. Robert A. Voltmann
Transportation Intermediaries Association
3601 Eisenhower Avenue, Suite 110
Alexandria, VA 22304

Robert P. Vom Eigen, Esq.
Hopkins & Sutter
888 16th Street, N.W., Suite 700
Washington, DC 20006

Mr. Terry J. Voss
AG Processing Inc.
P.O. Box 2047
Omaha, NE 68103-2047

Mr. Robert J. Wade
Toyota Logistics Services Inc.
P.O. Box 2991
19001 South Western Avenue
Torrance, CA 90509-2991

Mr. Patrick J. Whalen
President, Fulfillment Systems Int'l.
908 Niagara Falls Boulevard
North Tonawanda, NY 14120-2060

Mr. Darrell R. Wallace
Bunge Corporation
P.O. Box 28500
11720 Borman Drive
St. Louis, MO 63146-1000

Mr. Christopher I. West
Northwest Forestry Association
1500 SW First, Suite 330
Portland, OR 97201

Mr. William W. Whitehurst, Jr.
W.W. Whitehurst & Associates, Inc.
12421 Happy Hollow Road
Cockeysville, MD 21030-1711

Mr. Terry C. Whiteside
Whiteside & Associates
3203 3rd Avenue North, Suite 301
Billings, MT 59101

Thomas W. Wilcox, Esq.
Thompson Hine & Flory, L.L.P.
1920 N Street, N.W., Suite 800
Washington, DC 20036-1601

Mr. Richard V. Willmarth
Traffic Manager
GROWMARK, Inc.
1701 Towanda Avenue
Bloomington, IL 61701

Michael S. Wolly, Esq.
Zwerdling Paul Leibig Kahn Thompson
& Wolly
1025 Connecticut Avenue, N.W., Suite 712
Washington, DC 20036

Frederic L. Wood, Esq.
Thompson Hine & Flory, L.L.P.
1920 N Street, N.W.
Washington, DC 20036

Ms. Shirley J. Barra
Commonwealth of Virginia
P.O. Box 1475
Richmond, VA 23218

Mr. Daniel Yoest
Crossroad Carriers
1835 East Park Place Blvd., Suite 107
Stone Mountain, GA 30087

Michael F. McBride

Michael F. McBride